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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, [redacted] 1970

No. 331

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to United States Court of Appeals for the Sixth Circuit

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to United States Court of Appeals for the Sixth Circuit

Union Planters National Bank of Memphis, Petitioner, respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on May 4, 1970.

OPINIONS BELOW

The opinion of the Court of Appeals for the Sixth Circuit (unpublished) appears in the appendix hereto. The opinion of the District Court for the Western Division of

the Western District of Tennessee, reported at 295 F. Supp. 1151 (W. D. Tenn. 1969), also appears in the appendix, as does the judgment of the United States Court of Appeals for the Sixth Circuit entered May 4, 1970, and the judgment of the District Court in favor of the petitioner entered November 21, 1968.

JURISDICTION

The final judgment of the Court of Appeals for the Sixth Circuit was entered on May 4, 1970. The petition for certiorari is filed within ninety days of that date. The jurisdiction of this Court is invoked under 28 U. S. C. Sec. 1254(1).

QUESTION PRESENTED

Was petitioner, a National Bank, the owner of municipal bonds purchased from bond dealers obligated to repurchase them without loss to petitioner, so that interest income received thereon by petitioner prior to repurchase by dealers was exempt from income tax under Section 103 of the Internal Revenue Code, as was held by the District Court, or was petitioner simply a lender secured by bonds owned by bond dealers, so that interest income collected by petitioner was taxable income as though it were interest paid petitioner by dealers, as was held by the Court of Appeals?

STATUTORY PROVISIONS INVOLVED

No statutory provision is directly involved, but indirectly involved is that portion of Section 103 of the Internal Revenue Code, 26 U. S. C. 103(a), which provides:

> "General Rule.—Gross income does not include interest on—(1) the obligations of a State, a Territory, or a possession of the United States, or any political

subdivision of any of the foregoing, or of the District of Columbia, * * *"

Also indirectly involved, by reason of the Government's position, is Section 265 (b), Internal Revenue Code, which is as follows:

> Section 265. EXPENSES AND INTEREST RELATING to tax exempt income.
>
> No deduction shall be allowed for
>
> * * * * * * *
>
> (2) INTEREST. Interest on indebtedness incurred or continued to purchase or carry obligations * * * the interest on which is wholly exempt from taxes imposed by this sub-title.

STATEMENT OF THE CASE

The petitioner is a national bank with its principal banking offices in Memphis, Shelby County, Tennessee (15a).

For several decades, petitioner purchased public authority bonds from dealers under repurchase agreements by which petitioner could resell to the dealer at no loss to petitioner. (The written agreement is included in the appendix hereto.) Interest income on such bonds is not included within gross income. 26 U. S. C. 103(a). Petitioner received interest income while it owned such bonds, which the government nevertheless contends should be included within gross income and taxed as such.

Petitioner began purchasing public authority bonds in the late 1930s, when many public authorities had occasion to issue bonds to refinance outstanding bond issues at

* All references are to the printed appendix, filed in the Court of Appeals, which is included in the record filed in this Court.

lower interest rates and finance new projects. These bond issues were offered to the public but, in accordance with general practice, would be acquired first by one or more bond dealers on public bid, and would then be retailed to the bond dealers' various customers. Some banks found it desirable to compete with the bond dealers by purchasing such bond issues for their own accounts and reselling to their own customers. Other banks, such as petitioner, chose instead to work with the dealers rather than to compete with them. Petitioner did so within the states of Alabama, Mississippi, Louisiana, Tennessee and Arkansas, an area in which the issuing authorities and their bond issues were not large. Large eastern financial institutions were not interested in working with such issues on any basis. Petitioner found a field in which it could significantly benefit the economy of the entire area. As a result, petitioner developed the practice here involved (15a, 27a, 143a).

Petitioner concedes that this type of transaction tended to eliminate the dealers' need for loans secured by such bonds. But, the problem required a different solution; namely, purchase and ownership of the bonds by petitioner. The transactions were developed and handled solely on that basis. It is plain from the history of these transactions that at the time they were developed there was no thought of tax avoidance. There were numerous other compelling reasons for petitioner's interest in these transactions and for handling them as they were. One of the prime reasons was to create an available market for the bond issues so that the various governmental projects could be carried forward (27a, 28a, 80a, 83a). Another prime purpose was to afford the petitioner liquid, relatively short-term, investments for otherwise idle funds (88a). These transactions also provided a strong stimulus in the economic development of petitioner's entire trade area, and also was in furtherance

of the congressional policy behind Section 103 of the Internal Revenue Code: "to aid in the flotation of government bond and securities by making them tax free and therefore more attractive to investors." **Holley v. United States**, 124 F. 2d 909 (CA 6, 1942), cert. den. 316 U. S. 685; **American Viscose Corp. v. Comm'r. Internal Revenue**, 46 F. 2d 1037 (CA 3, 1932); cert. den. 287 U. S. 615.

There were still other reasons. Petitioner obtained the good will of many dealers by not competing with them and, instead, enabled them to sell more bonds than they could otherwise have done. Petitioner's role also led, in many instances, to being named trustee, or paying agent, or both. Petitioner earned fees for these services, and obtained increased deposits, consisting of the funds to be used for paying bond interest or principal. These funds were substantial and remained on deposit for long periods of time (86a, 87a).

Finally, it must, of course, be recognized that the coupon interest received by the petitioner while it held the bonds, although low in rate, was tax exempt, so that petitioner received a good rate on its investment, in most instances better than the commercial loan rate would have afforded (37a, 82a).

When this practice originated, the repurchase agreements were all oral. About 1951, at the suggestion of the bank examiners, a written agreement was drafted and generally used thereafter (28a, 79a, 80a, 95a, 96a, 123a). In many instances, however, the use of the written agreement was overlooked, and in some instances it may have been used with a dealer on one occasion but thereafter may have been neglected or overlooked. In any event, the oral understanding was the same, namely, that on demand from the petitioner a bond dealer would repurchase the bonds without loss or profit to the petitioner.

(80a). The oral agreement, of course, was not legally enforceable.

Throughout all of these years the routine followed has been the same. Generally, a dealer would bid on or agree to purchase all or part of an issue at a specific price. If he had sold all of the bonds to his customers by the time they were actually issued, transactions here involved would not come into play. If he had not found sufficient purchasers, he would pay for the bonds and then sell them to the petitioner under the repurchase agreement, usually delivering the bonds to the petitioner with an actual invoice for the agreed sale price and accrued interest. In some instances, he would ask the petitioner to pay the issuing authority and receive the bonds directly, but petitioner would receive from the dealer an invoice, showing a sale of the bonds to the petitioner under the repurchase agreement (15a, 17a, 67a, 84a, 86a).

Petitioner held these bonds until the dealer had found customers who desired them. While the petitioner had no obligation to convey the bonds to the dealers, the understanding was that it would do so. When the dealer wished to repurchase some of the bonds, petitioner sold them to him, with its own invoice to the dealer. In some instances, the dealer would request petitioner to ship the bonds directly to his customer. In such instances, petitioner also invoiced the dealer, showing a sale to the dealer, and the dealer, in turn, invoiced his customer (18a, 19a, 85a, 86a).

Petitioner usually owned the bonds less than six months. During its ownership, petitioner clipped the coupons and surrendered them for its own account. When a dealer repurchased bonds between coupon maturities, he would pay the petitioner accrued interest (88a).

During all the years that these transactions have been used, the petitioner has had two bond accounts on its ledgers. One was its bond reserve account and the other

its bond trading account. In the bond reserve account, petitioner carried only long-term, high-quality bonds purchased for its reserve investment fund. In the trading account, the petitioner carried lower-quality bonds held as short-term investments. These were of three classes: (1) bonds purchased individually for resale to the public; (2) bonds purchased as a member of a syndicate or joint venture, for resale to the public; and (3) bonds purchased from dealers under repurchase agreements (24a, 25a, 78a, 79a).

The record shows that the petitioner received an invoice when it purchased bonds of any character for any purpose, and issued one when it resold them. The record also shows a most material and substantial difference in the handling of the bonds held in the bond reserve account and those held in the trading account. Petitioner treated bonds held for its bond reserve account as loans, but did not so regard bonds held in its trading account. The record shows that petitioner through all these years had a loan or discount committee, which met daily. Every loan made by the petitioner had to be approved by that committee. Throughout the years, all purchases of bonds for the bond reserve account were submitted to the loan committee for approval. Without such approval, they were not purchased. Purchases of bonds for the trading account, however, including bonds purchased with repurchase agreements from the dealers, were never at any time submitted to the loan committee for approval (25a, 27a, 38a, 39a, 140a).

The record here shows that in setting up its ledgers and accounts covering these transactions, petitioner treated them as sales rather than loans. At all times prior to 1957, petitioner's records listed bonds held under repurchase agreements as assets and not as loans. In 1957, however, the Comptroller of Currency rendered an opinion (167a) in which he ruled that such bonds should be shown

as borrowing transactions and must be kept within the limitations provided in Section 5202 of the Revised Statutes (12 U.S.C. 82). Accordingly, the ledger sheets covering these transactions were stamped with the words, "Loans", "Bonds held under Repurchase Agreement", or with the word, "Carried", and the bonds were carried in the loan section of the petitioner's ledger (168a). Even after the 1957 ruling, petitioner identified these bonds as "Securities held under Repurchase Agreement" in its annual stockholders' reports, and did not include them in "loans and discounts" on its balance sheets (20a, 21a).

In March, 1964, the Comptroller reversed himself, and held that these transactions were not loans for any purpose. Thereafter, they were not included in loans on petitioner's books. They were carried as "state and municipal securities", which, of course, included bonds other than those held under repurchase agreements. Of course, even after the 1964 ruling some existing ledger sheets still carried the designation, "Loans, Bonds Held Under Repurchase Agreement", because the ledger sheets were set up with respect to each bond issue, and not with respect to each bond dealer, and remained in use until petitioner no longer owned any of such issue. Whenever petitioner was left free to do so, it never treated these bonds as loans. In fact, such bonds were not even treated as loans in computing petitioner's reserve for bad debts for tax purposes. Such reserve would have been increased by treating these bonds as loans, which would have decreased petitioner's taxes. Nevertheless, this was never done (176a).

It may be observed here that the government placed evidence in the record from one or two bond dealers that their own accountants required them to treat these bonds as assets offset by a loan liability to the petitioner. On the other hand, petitioner showed that other dealers did

not carry the bonds as assets in any manner, but simply footnoted a contingent liability under the repurchase agreements. The question of how the dealers carried them probably is not of any real significance, not only because some did it each way, but because it is clear in the record that the petitioner had nothing to say about how the dealers carried their records or set up their books.

There is evidence that one, and possibly some of the other dealers, in a trade magazine known as THE BLUE BOOK, advertised for sale the bonds which they were obligated to repurchase. The dealer, of course, knew that he could repurchase the bonds on request if he found the customer. The Government and the Court of Appeals seem to attach unusual significance to the fact that the dealers were permitted to advertise these bonds in the Blue Book. Any such significance vanishes completely when we look at the testimony of Mr. Lancaster that the dealers were allowed to advertise any bond carried by petitioner in its trading account, whether covered by a repurchase agreement or not. Mr. Lancaster, in rebuttal testimony, testified specifically that the entire trading account was made available to any number of dealers, who advertised those bonds in their booklets, including the Blue Book. Petitioner's entire trading account was, after all, held for resale to the public. He went on to explain that when a dealer was interested and asked what bonds the bank had available in the trading account, he, Lancaster, would give him full information. If the dealer found someone who wanted them, the bonds could then be moved (207a, 208a).

It is significant that in only three instances were dealers requested to repurchase bonds and failed to do so. In each instance, petitioner either sold the bonds to third parties or retained the bonds as an investment. Profits from the transaction were retained by the petitioner and were not paid to the dealer, as would have been required if the transaction had been a loan. In one case, the dealer

was indebted to petitioner on conventional loan transactions. If the bond purchase transaction had in reality constituted a loan, profit from the sale of the bonds would have been applied to reduce the other indebtedness of the dealer. The reduction was not made (89a, 95a).

Petitioner would not argue here the soundness of the opinion below. However, it will be of some value to discuss some of the fallacies of that opinion in the light of the actual facts involved. The Court below conceded that the form of the transactions was a purchase and resale, and not a loan. (Opinion below, p. A-3) The substance of the transactions also is incompatible with a loan, and reflects true ownership. A national bank cannot lend money without taking a note. None was taken in these transactions. The repurchase agreement was the sole instrument involved, and was not even written in most cases. It contained no obligation by the dealer to pay any affixed sum on a date certain or on demand. The agreement did not even obligate the dealer to repurchase the bonds at a certain figure. And petitioner was under no contractual obligation to return the bonds, as it would have been if the bonds were collateral for a loan.

The remedies available to the parties to the transaction were also inconsistent with a loan transaction. If the dealer refused to perform his repurchase agreement, petitioner could not obtain judgment for the value of the bonds, as if they were simply the amount of a loan. Petitioner could only obtain a judgment for damages resulting from the dealer's breach of his repurchase obligation; [illegible] any increase in market value since petitioner purchased them. On the other hand, if the dealer desired the bonds, he had no right to tender the money and obtain them, as he would have had if the bonds were simply security for a loan. Although petitioner usually did resell to dealers on request, the dealer could not legally

compel petitioner to do so. And, if petitioner sold the bonds to others at a profit, petitioner was entitled to, and did, retain the profit. If the bonds had been security for a loan, such profit would have been legally owed to the dealer. **Commissioner v. The Bank of California**, 80 F. 2d 389 (9th Cir. 1934); **Cowan v. Singer Mfg. Co.** (1893), 92 Tenn. 376, 21 S. W. 663.

The transactions here involved completely lacked the essential characteristics of a secured loan transaction. The court below overlooked these substantive differences. The court also incorrectly characterized the economic effect of the transaction. The opinion stated that, unless treated as a loan, "the dealer will have obtained the funds to purchase the bonds [from petitioner] without paying interest." (Opinion below, p. A-3.) But the dealer never purchased the bonds until he had a customer for them. He didn't "obtain funds" from petitioner when he operated under the repurchase agreement any more than he did when he obtained a customer for a bond held in petitioner's trading account which was not subject to any repurchase agreement; even the Government doesn't contend that interest on such bonds was taxable to petitioner. Nor does the dealer "obtain funds" from the issuing authority between the time the authority commits itself to sell to the dealer and actual issuance of the bonds, even though the dealer proceeds to obtain customers for the bonds on the assumption he can get them when he requests them from the authority. Moreover, the holding below means that any bond sold to a customer which the dealer agrees to repurchase means that the customer has loaned money to the dealer. Such a result is absurd. Finally, I. R. C., § 265 (2), is simply a limitation on **deductions**. This case deals solely with the definition of gross income, which Congress has explicitly narrowed to exclude the type of income received by petitioner while it owned the subject bonds.

While many facts were stipulated by the parties, many were not. The District Court heard evidence offered by both parties in open court, and from conflicting evidence found the following facts in addition to those stipulated.

1. The purchase price paid by petitioner when it purchased bonds from dealers and entered into the repurchase agreements was less than par and was usually the dealer's exact cost (210a).

2. In some instances the dealers, at the suggestion of their accountants, showed the bonds on their statements as their property, but in others they did not show them as their property, but showed a contingent liability by virtue of the repurchase agreement. In neither case did petitioner have anything to say as to how the bonds were carried in the dealer's records (212a-213a).

3. Bonds purchased by the petitioner in connection with repurchase agreements were never submitted to the petitioner's loan or discount committee for approval as were all bonds purchased for the petitioner's reserve account. The latter were considered as loans, while the bonds purchased for the trading account were not (213a).

4. There were only three instances where the dealers refused to repurchase when called upon by the petitioner. In each instance the petitioner sold the bonds for its own account and made a profit which it retained. The plan was developed by the petitioner in order to aid the small local dealers and in order to aid the issuing authorities who were not substantial enough to interest the large eastern banks. There were numerous indirect benefits accruing to the petitioner (213a-215a).

5. Petitioner owned the bonds and interest coupons while it held them, and exercised all elements of control and collection over the interest (214a).

REASONS FOR GRANTING THE WRIT

1. The decision below conflicts with the decisions of other Courts of Appeals as to the application of 26 U. S. C., § 103(a).

Section 103(a) of Title 26 excludes from gross income interest received on local governmental obligations. The Sixth Circuit here held that Section inapplicable to interest received by petitioner on bonds subject to repurchase agreements. This holding directly conflicts with the decisions of the Ninth Circuit in **Commissioner v. The Bank of California**, *supra*, affirming 30 BTA 566, and **Commissioner v. Wells-Fargo Bank**, 80 F. 2d 390 (9th Cir. 1934). These cases were not cited below despite the decisions in favor of the taxpayer rendered on virtually identical facts.

The Ninth Circuit cases involved similar transactions under a similar repurchase agreement (reprinted in the appendix hereto) which obligated the dealer to repurchase without loss to the bank. The agreement went further, however, in giving the dealer an option to purchase. If not repurchased, the bonds could be sold. Any profit was the bank's, but any loss was charged to the dealer. The bank retained all interest accrued during its ownership. The bonds were transferred at specified prices by invoice. The Ninth Circuit affirmed the finding of the Board of Tax Appeals "that the transactions referred to were actual purchases, not loans of money secured by pledge, and that the bonds belonged to and were the property of respondent." (80 F. 2d at 390.) In contrast, the court below found that "these transactions, although characterized as sales-repurchases by the parties, will be regarded as secured loans." (Opinion below, p. A-6). The conflict is apparent.

The Tenth and Fifth Circuits have also [illegible] question. Although the Tenth Circuit [illegible] taxpayer, its construction of [illegible] the Ninth Circuit. In **First National Bank of Wichita v. Commissioner**, 57 F. 2d 7 (10th Cir. 1932), U. S. 636, affirming 19 B. T. A. 744 (1930), [illegible] advanced the face value of securities, [illegible] market value, and its customer assigned [illegible] An agreement permitted the customer to [illegible] If the customer did not do so, the bank [illegible] in the market. Any profit, as well as any [illegible] to the customer. The agreement further required the customer to pay interest at the current loan rate [illegible] unrelated to the coupon rate and usually [illegible] ties considered the coupons to be the [illegible] not the bank's. When due, the bank delivered them to the customer, who cashed them in [illegible] The bank claimed no ownership in the coupons [illegible] attempted to exclude the commercial interest [illegible] by the customer from gross income. The Tenth Circuit affirmed the Board of Tax Appeals' finding that the interest paid by the customer was not excludable [illegible] purpose of the arrangement was to evade [illegible] under the banking laws.

The Board and the Tenth Circuit both held that the decisive question was which party, under the agreement, had the right to receive the coupon interest. The courts found, under the facts presented, that the bank, and not the customer, had the right to receive the tax-free interest. Thus, the **Bank of California** case [illegible] But the principle of decision, and the [illegible] (a), was the same. Both cases hold that the party who possesses the right to receive coupon interest, and that party, is entitled to exclude such interest from income. In its **Bank of California** opinion, the Board at

Tax Appeals explicitly applied the legal principles enunciated in **First National Bank in Wichita**, and held for the taxpayer because it did, in fact, own the interest. The trial court below found the same fact, applied the same law, and held for petitioner. The Sixth Circuit's reversal directly conflicts with both the Ninth and Tenth Circuits.

This question was more recently presented to the Fifth Circuit in **American National Bank of Austin v. U. S.**, 421 F. 2d 442 (5th Cir. 1970), petition for cert. filed, 37 U. S. L. Week 3, 466 (U.S. May 18, 1970) (No. 1587). The District Court followed the Ninth and Tenth Circuits and held for the taxpayer bank, which owned the right to the coupon interest [296 F. Supp. 512 (W. D. Tex. 1968)]. The facts differed from the instant case and **Bank of California** in only two respects: there were no written agreements at all, and the dealers had the option, but no obligation, to repurchase the bonds. In the instant case, the dealers had the obligation, but no option. In **Bank of California**, they had both the option and the obligation. The trial court found that the First National Bank of Austin was the party to the transaction which had the right to receive coupon interest (296 F. Supp. 512, 513). The Fifth Circuit declined to apply the clearly erroneous rule, and reversed on the basis of its own finding that a genuine basis in reality for the bank's ownership of the coupons was "absent here when all the facts and circumstances are carefully examined" (421 F. 2d at 454). It is clearly apparent that the Fifth Circuit decision also directly conflicts with those of the Tenth and Ninth Circuits.

2. **The decision below conflicts with the decisions of other Courts of Appeals concerning the scope of appellate review in tax cases.**

Rule 52(a) of the Federal Rules of Civil Procedure (28 U. S. C.) provides:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of witnesses."

The trial courts in each of the five cases dealing with this issue found **as a fact** that the taxpayer either possessed, or did not possess, the right to receive coupon interest. The Ninth and Tenth Circuits limited their review to a determination of whether or not the finding was reasonably supported in the record. The court below virtually conceded that the evidence conclusively established that petitioner possessed the right to receive coupon interest, when it stated: "There is little dispute here about what obligations and rights the parties expected their agreement to confer." (Opinion below, p. A-4.) In direct conflict with the Ninth and Tenth Circuits, however, the court declined to be bound by the finding, stating that the issue was legal rather than factual. (Opinion below, p. A-4) The Fifth Circuit, in **Bank of Austin**, felt similarly unfettered by its trial court's finding; stating: "obeisance to the clearly erroneous rule must yield when the facts are undisputed and we are called upon to reason and interpret." (421 F. 2d at 451.)

The decision below directly conflicts with those of the Ninth and Tenth Circuits in treating the issue of ownership of coupon interest as a question of law, rather than fact, and in failing to properly limit appellate review of the trial Court's determination on this issue.

3. The decision below determined a federal question in a way in conflict with applicable decisions of this Court.

This Court has held that the question of ownership of assets under the federal tax laws is a question of **fact. Helvering v. Clifford**, 309 U. S. 131 (1946). As such, the

trial Court's factual determination that petitioner owned the bonds, the coupons, and the tax-free income derived therefrom, may not be disturbed unless it was "clearly erroneous" under Fed. R. Civ. P. 52(a) (28 U. S. C.). **Commissioner v. Duberstein**, 363 U. S. 278 (1960). The rule "applies also to factual inferences from undisputed basic facts." *Id.*, 363 U. S. at page 291.

Contrary to the holdings of this Court, the court below held that the question of ownership was one of law, not fact, and refused to apply the clearly erroneous test:

> "Accordingly, we are not bound by the District Court's conclusion that the Bank should be treated as the owner of the bonds for federal income tax purposes." (Opinion below, p. A-4.)

In accordance with **Helvering v. Clifford**, *supra*, the trial Court's determination was a factual **finding**, and was not a legal conclusion as stated in the portion of the Opinion below just quoted. The trial court properly stated: "The Court finds that the Bank was the owner of the bonds and interest coupons . . ." (213a-214a). As previously noted, there is little doubt about this fact. Yet the court below called it a legal question and drew the opposite inference, in direct conflict with this Court's holdings in **Clifford** and **Duberstein**.

The court below sought to avoid **Duberstein**, by stating:

> "We are not here concerned with an area of the law where intent determines whether or not an increment of wealth is to be deemed income, as was the case in [**Duberstein**] . . . Here the question is not whether or not an increment of wealth is income (for it clearly is), but whether it is income from interest paid by a borrower, or tax-exempt interest from municipal bonds." (Opinion below, p. A-5.)

With due respect, the court below misread **Duberstein**. The statute there involved [26 U. S. C., § 102(a)] excludes from gross income property acquired by gift. (363 U. S. at 279-280.) The instant case involves a statute which excludes from gross income property acquired as interest on municipal bonds. In both cases, the basic factual question is whether the property which the government sought to include in gross income was in reality received by the taxpayer as a substitute for something else (personal services in **Duberstein**; loan interest, here). This court applied the clearly erroneous test to the trial court's findings, and stated:

> "It seems to us plain that as trier of the facts (the Tax Court) was warranted in concluding that despite the characterization of the transfer of the Cadillac by the parties and the absence of any obligation, even of a moral nature, to make it, it was at bottom recompense for Duberstein's past services, or an inducement to him to be of further service in the future." (363 U. S. at 291-292.)

The court below directly conflicted with this Court by dismissing the trial court's contrary finding, and basing its decision on its own opinion that the coupon interest received by petitioner was in reality recompense for a "loan". The unfettered appellate review indulged in by the court below is precisely what this court heretofore instructed the same court it must not do, in reversing the Sixth Circuit in **Duberstein**.

4. The decision below determines an important question of federal law which has not been, but should be, settled by this Court.

The basic issue here presented—whether or not the owner of "tax-exempt" bonds subject to a repurchase agreement, who possesses the right to receive coupon

interest, may exclude such interest from gross income—has been before the Courts of Appeals five times. This record reflects the fact that the transactions involved are numerous, of long standing, wide-spread, and crucial to the effective functioning of the municipal bond market. The statute involved was specifically enacted for the purpose of aiding in the flotation of local governmental bonds and securities. **American Viscose Corp. v. Commissioner**, 56 F. 2d 1033, 1034 (3d Cir. 1932).

The court below, and the Fifth Circuit in **Bank of Austin**, have created a significant exception to § 103(a) which (as this record establishes conclusively) will seriously erode the Congressional policy behind its enactment. **Bank of California** has stood for 35 years undisturbed by Congress. Nor has Congress evidenced any intent to treat differently those dealing in governmental bonds within the Fifth and Sixth Circuits, and those located elsewhere. This Court should pass on such a significant modification of long-standing federal policy. More important, a decision by this Court is necessary to again make uniform throughout the country the federal tax treatment of federally-chartered banks. This case alone directly involves approximately one million dollars. The indirect economic repercussions upon governmental units which issue bonds, upon dealers who make the market function, upon banks which assist dealers to perform that function, and upon those who ultimately invest in such bonds, are incalculable. Petitioner feels strongly that this issue is of such extreme importance as to justify full consideration by this Court.

CONCLUSION

For the foregoing reasons, petitioners pray that a writ of certiorari issue to review the judgment of the Sixth Circuit in this case.

Respectfully submitted

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APPENDIX A

No. 19409

United States Court of Appeals
for the Sixth Circuit

Union Planters National Bank of Memphis, Plaintiff-Appellee, v. United States of America, Defendant-Appellant.	On Appeal from the United States District Court for the Western District of Tennessee, W. D.

Decided and Filed May 4, 1970.

Before: Celebrezze, McCree, and Combs, Circuit Judges.

McCree, Circuit Judge. This appeal presents the question whether coupon interest collected by a bank as owner of municipal bonds subject to repurchase agreements is exempt from taxation under § 103(a) of the Internal Revenue Code. We hold that under the circumstances of this case, it is not and accordingly we reverse the decision of the District Court, 295 F. Supp. 1151 (W. D. Tenn. 1968). Since 1938 or 1939, appellant Bank has purchased municipal bonds[1] from local bond dealers, subject to agreements permitting the Bank to require repurchase by the dealer at any time at the price paid by the Bank. The evidence does not disclose an instance when

[1] The term "municipal bonds" is used in this opinion to include those bonds and obligations issued by states, municipalities, and other local governmental units, which qualify for the exemption granted by § 103(a).

the Bank invoked this provision. Rather, as the District Judge found, "it was the intent and practice that the bonds be re-acquired by the dealer upon the dealer's request. . . ." 295 F. Supp. at 1152. The dealer usually repurchased the bonds when he had found a customer for them. The Bank invariably resold to the dealer at the same price it had paid him (this price was either the dealer's cost or a lower figure), and the dealer's repurchase at this price protected the Bank from experiencing any loss on the transaction.

During the period in which the Bank held the bonds, it would clip bond coupons as they matured and collect and retain the interest. On repurchase by a dealer, the Bank would be credited with the pro rata interest accruing from the last coupon redemption date until the date of repurchase. The tax treatment of coupon interest realized by the Bank in this manner in the years 1961-64 is the subject of this appeal.

The Bank claims that since it was the owner of the bonds and the coupons, the interest income from them should be exempt from taxation under § 103(a). The Government, on the other hand, insists that each transaction between the Bank and the dealers was in reality a loan secured by what was in effect a pledge of the bonds. Thus, the coupon interest belonged to the dealers and, when they permitted the Bank to keep it, they were paying the Bank what was in effect ordinary interest on the loan, which is income not exempt from taxation under § 103(a). Viewed in this context, the Government argues, the transactions constitute an attempt to avoid the effect of § 265(2) of the Internal Revenue Code. This provision disallows deductions of interest paid on loans the proceeds of which are used to buy municipal bonds. Its obvious purpose is to deny the recipient of tax exempt income the further tax benefit of deducting the cost of money

employed to purchase the securities which produce it. Accordingly, if the dealer had borrowed the money to purchase the bonds, the coupon interest would be tax-free to him, but he would not be able to deduct the interest paid to the Bank for the loan; and the Bank, of course, would be taxed fully on the income represented by that interest. But if the transactions are characterized as sales-repurchases, the Government contends, the Bank will avoid paying tax on the coupon interest, which in economic effect is equivalent to interest paid for the use of its money, and the dealer will have obtained the funds to purchase the bonds without paying interest. Thus, if the parties' characterization of these transactions is accepted as decisive for federal income tax purposes, they would be able to enjoy the benefit of the double tax advantage which Congress intended to prevent.

The form of these transactions tends to support the Bank's arguments. And the Government does not dispute the fact that the Bank held title to the bonds in a property law sense. Moreover, the Bank did not list these transactions on its books as "loans" except when required to do so by the Comptroller of the Currency from 1957 to 1964.[2]

However, other facts found by the District Court support the Government's position. The bond dealers would list these bonds for sale in trade publications in the same manner as bonds to which they held legal title. When a dealer found a customer for the bonds, he would repurchase them from the Bank which never refused to resell although, under the written repurchase agreements, it was

[2] Although not listed as loans during 1938-57 and 1964-70, nevertheless they were not carried on the Bank's books in the same category as bonds purchased for investment, which were of course not subject to the kind of repurchase agreements we are concerned with here.

not bound to do so. The District Judge found that it was understood between the parties that the Bank would always consent to such repurchases. More important, the Bank was protected under the repurchase agreements from suffering any loss, and its gain was limited to the amount of coupon interest accruing during the time it held the bonds.[3] In some cases, when the market price of the bonds was falling, the Bank required the dealer to pay, in advance of repurchase, money sufficient to protect it in the declining market. Obviously this practice served the same purpose as the requirement of the posting of additional margin by a borrower whose security is decreasing in value. It is clearly more consistent with the characterization of these transactions as loans than as sales.

The District Court, in ruling for the Bank, held that "[t]he determination of this case requires an inquiry into the intent of the parties." 295 F. Supp. at 1162. We do not agree that subjective intent is decisive here. The intent of the parties may be important in determining just what their contractual relations *inter se* were, but there is little dispute here about what obligations and rights the parties expected their agreement to confer. This case hinges, rather, on the legal characterization, for federal income tax purposes, of the transactions between the parties. That characterization is not a question of fact, but rather one of law. *Cf. Corbetta Const. Co. v. Dayton Rubber Co.*, 290 F. 2d 858 (6th Cir. 1961). Accordingly, we are not bound by the District Court's conclusion

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[3] On three occasions when the dealer refused to repurchase on demand by the Bank, the Bank sold the bonds to a third party and kept the resulting profit. The record does not disclose the details of these transactions, except that in one case the dealer was "probably insolvent". We would assume that all three dealers in question were insolvent or defunct; otherwise why would they refuse to repurchase when a profit was apparently guaranteed? In any event, these isolated incidents do not alter our opinion about the substance of the many dozens of these transactions.

that the Bank should be treated as the owner of the bonds for federal income tax purposes.[4]

We are not here concerned with an area of the law where intent determines whether or not an increment of wealth is to be deemed income, as was the case in *Commissioner v. Duberstein*, 363 U. S. 278 (1960), where the presence or absence of a subjective state of mind, donative intent, was declared to be decisive. Here the question is not whether or not an increment of wealth is income (for it clearly is), but whether it is income from interest paid by a borrower, or tax exempt interest income from municipal bonds.

In cases where the legal characterization of economic facts is decisive, the principle is well established that the tax consequences should be determined by the economic substance of the transaction, not the labels put on it for property law (or tax avoidance) purposes. *E. g., Commissioner v. P. G. Lake, Inc.*, 356 U. S. 260, 266-67 (1958); *Gregory v. Helvering*, 293 U. S. 465 (1935). "In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding." *Helvering v. Lazarus & Co.*, 308 U. S. 252, 255 (1939).

Here it is clear that the coupon interest functioned as the interest collected on a loan, however the parties may have characterized the transactions on their books. Like any secured lender, the Bank took great pains to insure

[4] The intent which the District Court found binding was apparently the bank's intent to adopt the form of sale and repurchase, rather than that of a secured loan. It should come as no surprise that taxpayer wished to characterize the transactions in this way, because it results in minimum tax liability, and does not give any of the parties any economic rights which they would not have had if the transactions had been characterized as loans. If this kind of intent is to be decisive, then, as the Government argues, any taxpayer could "determine its own tax liability by choosing the names which its arrangement should be called when those labels will affect nothing but its tax liability." *Cf. Burnet v. Harmel*, 287 U. S. 103, 110 (1932).

itself against any loss of principal, even to the extent of requiring margin payments (which took the paper form of advances on the repurchasing price). And like any borrower on security, the dealer was obliged to pay only the amount of the principal in order to extinguish his obligation, besides having to forego the gains he would otherwise have made through the maturing of interest coupons. In contrast, in a transaction that would be characterized as a sale for tax purposes, we would expect the Bank, rather than the dealer, to assume the risk of fluctuations in the market value of the bonds.

The Fifth Circuit has recently ruled for the Government in a substantially identical case. *American National Bank of Austin v. United States*, No. 27301 (Jan. 19, 1970). We think that the Government's case here is, on balance, stronger than in the *Bank of Austin* case. Here, there were written repurchase agreements under which the Bank could oblige the dealer to repurchase at any time at a price which would guarantee the Bank against any loss; in *Austin*, the dealers had only an unwritten option to repurchase, and there was no written contract as there was here. Other differences between the operations of the Austin and Memphis banks[2] we deem immaterial.

We hold, for the reasons found persuasive by the Fifth Circuit in Judge Ainsworth's opinion, that these transactions, although characterized as sales-repurchases by the parties, will be regarded as secured loans for federal income tax purposes, and that accordingly, the Bank, as economic lender, cannot exclude the bond interest from its taxable income. The judgment of the District Court is reversed, and the case is remanded for entry of judgment and other proceedings not inconsistent with this opinion.

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[2] Apparently the Austin bank usually conveyed bonds directly to customers of the dealers. The Memphis bank, with a few exceptions, consistently observed the formalities of sale and repurchase. Of course such adherence is not dispositive in tax cases when the real question is the economic substance of the transaction.

APPENDIX B

United States Court of Appeals
for the Sixth Circuit

No. 19,409

Union Planters National Bank of Memphis,
Plaintiff-Appellee,

vs.

United States of America,
Defendant-Appellant.

Before: Celebrezze, McCree and Combs, Circuit Judges.

Judgment

Appeal from the United States District Court for the Western District of Tennessee.

This cause came on to be heard on the record from the United States District Court for the Western District of Tennessee and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and the case remanded for further proceedings consistent with the opinion.

It is further ordered that Defendant-Appellant recover from Plaintiff-Appellee the costs on appeal, as itemized below, and that execution therefor issue out of said District Court.

Entered by order of the Court.

Carl W. Reuss
Clerk

APPENDIX C

In the District Court of the United States
for the Western District of Tennessee
Western Division

Union Planters National Bank of Memphis, Plaintiff, vs. United States of America, Defendant.	No. 67-102 Civil

Opinion

The Plaintiff, Union Planters National Bank of Memphis, brings this suit to recover income taxes paid by it pursuant to assessments of the Commissioner of Internal Revenue for the taxable years 1961, 1962, 1963 and 1964. The controversy concerns the applicability of 26 U. S. C., § 103 which exempts from income taxes the interest on bonds of a state or any political subdivision thereof. Such bonds hereinafter will be called municipal bonds. The Bank did not report as income the interest it received on municipal bonds which were subject to repurchase agreements. These repurchase agreements pertain to transactions between the Bank and security dealers, who transferred the municipal bonds to the Bank for an agreed price plus accrued interest and later reacquired the bonds. During the period that the Bank held the bonds it collected the interest provided for on the coupons attached to the bonds. The Bank contends that it was the owner of the bonds during that period and, therefore, the interest it collected was tax-exempt. The Commis-

sioner contends that the transaction was a loan by the Bank to the dealer whereby the municipal bonds were used as collateral; therefore, the interest received by the Bank was, in fact, interest paid by the dealer on a loan and the interest lost its exempt status.

The determination of this case requires an inquiry into the intent of the parties. The intent of the parties must be determined by the facts and circumstances reflected by the proof in the cause. The significant facts established by the proof are found by the Court to be as follows:

The plaintiff is a National Bank of significant stature in Memphis, Tennessee, and the surrounding area. As of December 31, 1962, the financial statement of the Bank indicated it had resources of $489,625,000.00. In 1938 or 1939 the Bank commenced a practice of entering into repurchase agreements with security dealers in Memphis and the surrounding territory. In these transactions the security dealers had agreed to purchase all, or part, of a bond issue from the state or municipal authority in the regional area. After delivery of the bonds, the dealer took the bonds to the Bank and transferred them to the Bank for money based upon an agreed price which purported to be the cost price. In the usual practice this price was set by the head of the Bond Department of the Bank. The price was less than par value of the bonds and usually the dealer's cost. The transfer was called a sale from the dealer to the Bank and under the terms of the agreement the dealer agreed to repurchase the bonds upon demand by the Bank. The dealer further agreed that the Bank would incur no loss in the transaction. In about 1951, at the suggestion of the Bank Examiners, a written agreement to this effect was adopted and used in most of such subsequent transactions. This written agreement was in use for the years involved in this suit. In some cases no written agreement was executed for

transactions of this character, but the bonds were transferred subject to the same terms as those of the written agreement.

Although the written agreement did not so provide, it was the intent and practice that the bonds be re-acquired by the dealer upon the dealer's request and payment of the value of the bonds. The length of time that the Bank usually held the bonds varied. In most instances the dealer re-acquired the bonds in less than six months. At the time of the transfer of the bonds by the dealer to the Bank, in addition to the agreed purchase price of the bonds, the dealer received accrued interest calculated from the last date that interest was paid by the issuing authority. If the coupons providing for the payment of interest became due while the Bank held the bonds, the Bank invariably clipped the coupons and collected the interest from the issuing authority. Upon the re-acquisition of the bonds by the dealer the Bank collected accrued interest to the date of re-acquisition. The repurchase price was based upon the amount originally paid to the dealer and the Bank made no additional charges nor received any compensation other than the coupon interest.

In some instances the dealer did re-acquire in several transactions less than all of the bonds that the dealer had transferred to the Bank originally. On some of those partial re-acquisition transactions the dealer did not receive the full prorata portion of the original price of the bonds. The amount received was determined by the date when certain bonds within the issue became due, which is a determinative factor in prices of bonds within the same issue.

The record also reflects that on some occasions the Bank required the dealer to pay additional monies while

the Bank held bonds acquired from that dealer. This was considered by the Bank to be an adjustment of the original purchase price and necessary to protect the Bank with regard to that portion of the agreement whereby the dealer agreed that the Bank would not incur any loss on the transaction.

In some instances the Bank, on instructions from the dealer, delivered some of the bonds to customers of the dealer in lieu of transferring the bonds back to the dealer. In those instances, the Bank settled with the dealer upon the price paid to the dealer and the dealer realized as profit the amount of the excess charged to the customer.

In 1957, the Comptroller of Currency issued a ruling requiring this Bank and others to show repurchase transactions on the books of the Bank as loans. In March 1961 the Comptroller of Currency reversed this ruling. During the period that the Bank was required to indicate that repurchase securities were loans, the Bank complied with the requirements of the Comptroller and reported the transactions in its financial statements as "Loans in Repurchase Agreements on Securities". At all times the Bank's books have reflected these transactions in a manner different from municipal bonds which the Bank held for re-sale to Bank customers or which it held in its own investment account. In some instances the Bank actually purchased bonds that it was "carrying" under repurchase transactions. When this was done the Bank paid the dealer the difference between the repurchase price and the market price and appropriate entries were made transferring the bonds on the books of the Bank to a different category of ownership.

The proof reflects that the dealers who had transferred securities to the Bank in transactions of this sort treated the bonds differently during the period the Bank actually

held the bonds. Some dealers treated the bonds as their own assets and showed a corresponding liability to the Bank on their financial statements. Other dealers reflected a contingent liability to the Bank based upon their obligation to repurchase upon demand from the Bank. There is no evidence that the Bank voiced any control over how the dealers handled the transaction. One dealer advertised for sale to its customers those bonds which had been transferred to the Bank. Presumably, this was based upon the understanding and fact that the dealer could re-acquire the bonds upon its request at any time. If a customer of the dealer wished to buy the bonds, the dealer could request the bonds from the Bank and make a profit on the sale to the customer of the dealer.

Negotiations for the repurchase agreement and decision of a discretionary nature pertaining to the agreements were made by the head of the Bond Department of the Bank. These transactions were not presented to the Loan Committee of the Bank which was required by bank practices to approve loans made by the Bank. Although the dealers usually had a line of credit with the Bank and were loan customers for other type transactions, the amounts involved in the repurchase transactions were never sufficient in size to suggest that the repurchase agreements were an effort to circumvent the laws and regulations which limit the amount that a bank might lend any one person or company.

There have been three instances whereby dealers who had transferred bonds to the Bank were unable to repurchase the bonds. In those instances which arose by transfers originating in the years 1945, 1955 and 1956, the Bank subsequently, upon failure of the dealer to re-acquire the bonds after demand, either sold the bonds to third parties or retained the bonds as the Bank's own investment. Profits realized from these transactions were

retained by the Bank and not delivered to the defaulting dealer.

From all of the facts reflecting upon the intent of the parties, the Court finds that the Bank was the owner of the bonds and interest coupons during the period between the transfer by the dealer on to the Bank and the reacquisition of the bonds by the dealer. In this regard, it should be noted that it is significant that coupons which contain the right to collect interest from the issuing authority may have separate ownership. **Edwards v. Bates Co.**, 163 U. S. 269; **Nesbit v. Riverside Independent District**, 144 U. S. 610; **First National Bank of Wichita v. Commissioner**, 57 F. 2d 7 (C. A. 10, 1932). Although some of the facts suggested loan transactions with regard to the bonds, the facts of the instant case clearly establish that the Bank exercised all elements of control and collection over the interest coupons while it held the bonds.

In addition to the determination of the intent of the parties the purpose of the transactions should be considered. The tax-exempt status of municipal bonds was established by Congress "to aid in the flotation of government bonds and securities by making them tax-free and therefore more attractive to investors." **Holley v. United States**, 124 F. 2d 909 (C. A. 6, 1942), cert. den. 316 U. S. 685; **American Viscose Corp. v. Commissioner of Internal Revenue**, 56 F. 2d 1033 (C. A. 3, 1932) cert. den. 287 U. S. 615. The proof in this case reflects, and the Court finds, that the Bank and dealers developed the repurchase practice primarily for the purpose of aiding the dealers in the handling of bonds from relatively small issuing authorities. Both the dealers and the issuing authorities were modest in size and therefore were not likely prospects to attract the larger national investment sources. The practice has been a stimulus to progress in

the immediate geographical area served by the Bank and the dealers.

The proof also establishes that there were indirect benefits to the Bank from these repurchase transactions. They constituted short term ventures, which are necessary for the operation of a well run bank. Good will and business of the security dealers is promoted by permitting the dealers to purchase from the issuing authority and then reselling to the Bank in preference to the Bank being the purchaser direct from the issuing authority and then undertaking to sell the bonds to investors. Furthermore, the co-operative role of the Bank in the issuing authority dealer efforts to float the bond issue stimulates the naming of the bank as trustee under the bond issue or the paying agency as well as increasing the deposits of the bank.

The Bank cites and relies on **Bank of California v. Commissioner of Internal Revenue**, 30 B. T. A. 556, affirmed in **Commissioner v. Bank of California**, 80 F. 2d 389 (C. A. 9, 1935). In that case a similar repurchase agreement was considered and the interest received by the Bank was found to retain its exempt status. This Court believes that the facts of the instant case are sufficiently similar to make that case persuasive authority in the determination of the issues in the instant case. The Commissioner in the instant case relies upon **First National Bank of Wichita v. Commissioner**, *supra*, wherein the Court of Appeals for the Tenth Circuit affirmed a holding by the Board of Tax Appeals that the repurchase transaction in that case was, in fact, a loan and that the dealer continued to own the interest coupons. This Court is of the opinion that the facts of the instant case are clearly distinguishable from the Wichita Bank case. In the Wichita Bank case the Bank charged the dealer interest

on a monthly basis and when the coupons became due the Bank delivered the interest coupons to the dealer. Furthermore, the interest charged to the dealer was not in all instances the same as the interest provided for on the bonds. In the Wichita Bank case the dealer substituted bonds during the course of the transaction. In the instant case no substitution was made and the bonds transferred by the dealer and re-acquired were in all instances identical.

For the reasons set forth above, the Court is of the opinion that the Bank was entitled to treat the interest received by it from municipal bonds as tax-exempt and therefore the Bank is entitled to a judgment for recovery of the tax heretofore assessed by the Commissioner.

This 24th day of October, 1968.

Robert M. McRae, Jr.
United States District Judge

A true copy.

Attest:

W. Lloyd Johnson, Clerk
By H. W. Daniels, D. C.

APPENDIX D

In the District Court of the United States
For the Western District of Tennessee
Western Division

Union Planters National Bank of Memphis,

Plaintiff,

vs.

United States of America,

Defendant.

No. 67-102 Civil

Judgment

This cause came on to be heard by the Court, sitting without a jury, upon the complaint filed by Union Planters National Bank of Memphis seeking a refund of moneys paid by it to the defendant, United States of America, by way of income taxes pursuant to assessment by the Commissioner of Internal Revenue of additional income taxes allegedly owed by the plaintiff for the calendar years of 1961, 1962, 1963 and 1964 by reason of the failure of plaintiff to report as taxable income certain interest received by it during the named taxable calendar years, which interest was paid on bonds issued by state and municipal authorities and was claimed by plaintiff as tax-free income under the provisions of 26 U. S. C. 103, the answer of the defendant, the written stipulation of facts entered into by the parties and filed in the cause, the interrogatories filed by the defendant on January 3, 1968 and the answers thereto filed by the plaintiff on January 23, 1968, the evidence of the witnesses offered by the parties in open Court, the entire record in the cause and the written briefs submitted by counsel for the parties, from all of

which it appears to the Court, for the reasons stated in its written opinion heretofore filed in the cause on October 24, 1968, which written opinion contains the Court's findings of fact and conclusions of law, that the plaintiff is entitled to recover from the defendant the additional taxes and interest paid by it pursuant to said assessments and sought to be recovered in this cause, which additional taxes and interest the Court finds to have been paid by plaintiff to the defendant on April 24, 1967 in the amount of Six Hundred and Forty-Seven Five Hundred and Forty-two & 55/100 ($647,542.55) Dollars.

It is accordingly Ordered that plaintiff, Union Planters National Bank of Memphis, do have and recover of and from the defendant, United States of America, the sum of Six Hundred and Forty-Seven Thousand Five Hundred and Forty-Two & 55/100 ($647,542.55) Dollars together with interest thereon at the rate of 6% per annum from April 24, 1967 until paid.

.....

United States District Judge

Approved

.....

Attorney for Plaintiff

.....

Attorney for Defendant

APPENDIX E.

Bank of California's Repurchase Agreement

"REPURCHASE AGREEMENT

"THE BANK OF CALIFORNIA, N. A., San Francisco, California, a National Banking Association, hereinafter termed 'Seller', agrees to sell, and R. H. MOULTON & COMPANY, hereinafter termed 'Buyer', agrees to buy the following bonds, namely:

"$7,000 City of Hartford Municipal Improvement 5% Bonds.

"Numbers and denominations as follows:

$2,000	Aug. 1, 1958	Nos. 173 74
4,000	Aug. 1, 1961	Nos. 186 89
1,000	Aug. 1, 1963	Nos. 199

"The purchase price of each bond is as follows: (Plus accrued interest)

August 1, 1958 maturity at 95
August 1, 1961 maturity at 95
August 1, 1963 maturity at 95

"payable in United States gold coin of the present standard of weight and fineness, which sum Buyer hereby agrees to pay on or before ninety days from date hereof. Maturing coupons to be the property of THE BANK OF CALIFORNIA, N. A.

"And THE BANK OF CALIFORNIA, N. A. hereby agrees on tender of said purchase price of such bonds and interest as aforesaid to deliver to R. H. MOULTON & COMPANY or its nominee, the bonds as above, at any time hereafter, prior to any default on the part of the Buyer.

"It is further understood between the two parties hereto that partial sales and deliveries may be made at the rates stated above.

"In the event of any failure on the part of the Buyer to accept and pay for any one or more of said bonds at the time the same is tendered, the Seller shall be released from all obligation in law or equity hereunder and may sell all bonds remaining in its hands without notice and for the best price obtainable, charging the loss, if any, to the account of the Buyer.

"Executed in duplicate this 11th day of July, 1929.

"R. H. Moulton & Company
"(Signed) by Elmer Booth
The Bank of California, N. A.
Stuart F. Smith
Vice-President"

APPENDIX F

Petitioner's Repurchase Agreement

REPURCHASE AGREEMENT

"The undersigned is this day selling to Union Planters National Bank of Memphis the bonds listed on Exhibit 'A' attached hereto, and as a condition of said sale and in order to induce Union Planters National Bank of Memphis to purchase said bonds from the undersigned, the undersigned now agrees that on demand made by Union Planters National Bank of Memphis from time to time, it will repurchase from Union Planters National Bank of Memphis any or all of the bonds listed on said Exhibit 'A' for an amount which will be sufficient to prevent Union Planters National Bank of Memphis from suffering or sustaining any loss on the resale of such bonds, and the undersigned hereby fully guarantees and agrees to indemnify Union Planters National Bank of Memphis against any and all loss sustained on or as the result of the resale to the undersigned of said bonds or any of them.

"This .... day of ....., 19....

....."

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No. 331

In the Supreme Court of the United States

OCTOBER TERM, 1970

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ERWIN N. GRISWOLD,
Solicitor General,

JOHNNIE M. WALTERS,
Assistant Attorney General,

WILLIAM A. FRIEDLANDER,
GARY R. ALLEN,
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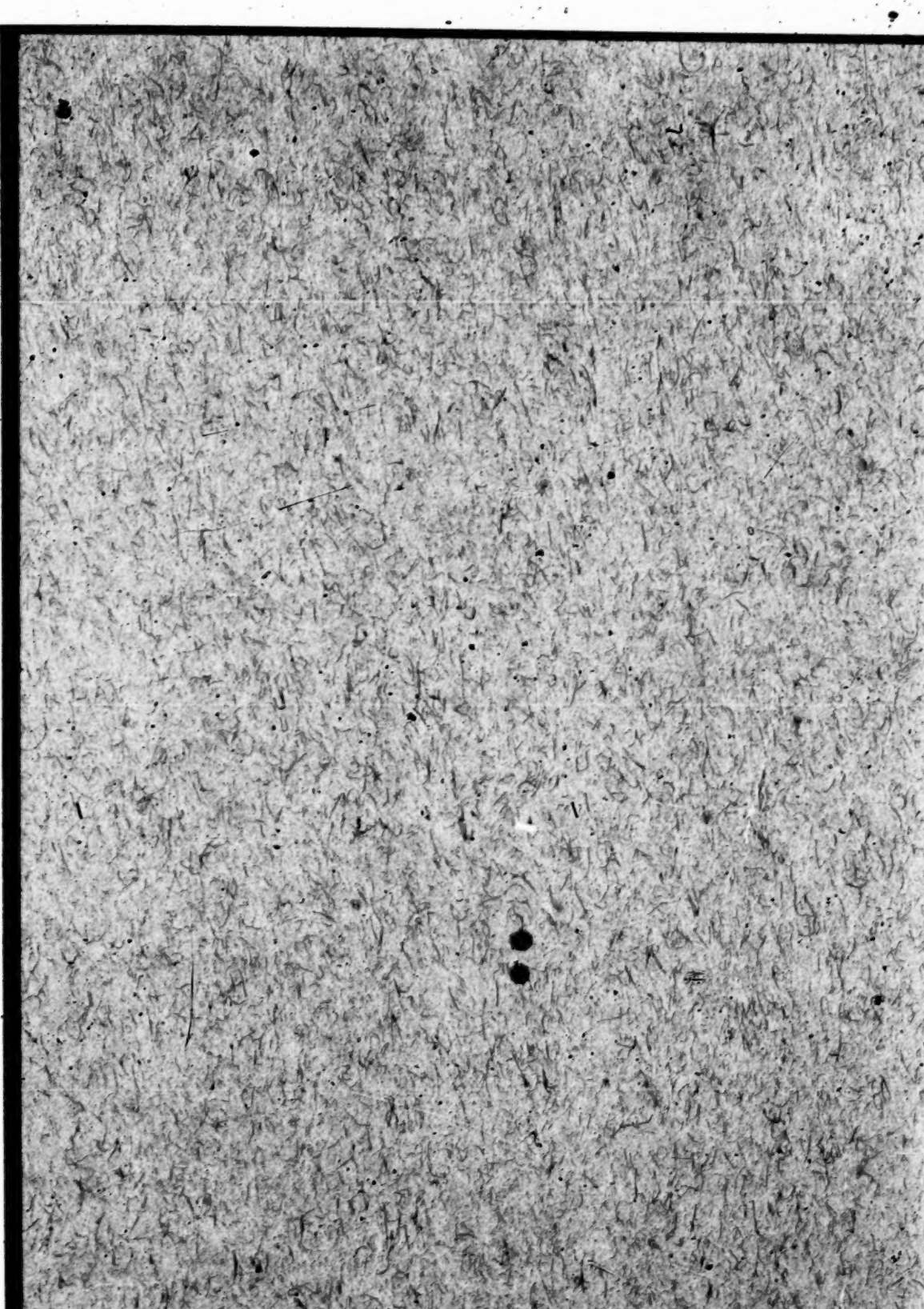

In the Supreme Court of the United States

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No. 331

UNION PLANTERS NATIONAL BANK OF MEMPHIS,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

This case presents the same question as that raised in *American National Bank of Austin* v. *United States*, 421 F. 2d 442 (C.A. 5), taxpayer's petition for certiorari pending, No. 168, this Term—whether a national bank was taxable on interest it received on certain municipal bonds because, in substance, it acquired and held these bonds not as the owner thereof, but as a secured lender.

In each case, the taxpayer contended and the district court found that the form of the transactions be-

tween the bank and municipal bond dealers, under which the bank was the owner of the bonds, was determinative of the tax consequences. Accordingly each district court held that, as owner, the bank was entitled to exclude the interest on the bonds from gross income under Section 103 of the Internal Revenue Code.

On appeal in each case, the court of appeals held that the ultimate question presented—whether the bank was the owner of the bonds or a secured lender—was one of law, subject to plenary review on appeal, rather than one of fact, subject to limited review under the clearly erroneous rule. Each court of appeals also held that, notwithstanding the form of the transactions between the bank and dealers, the dealers were the true owners of the bonds, the bank was a lender with the bonds pledged as security for the loans, and the interest received by the bank was in substance interest collected on loans to the dealers and not tax-exempt interest on the bonds. Accordingly, the district court decision in each case was reversed, the Sixth Circuit below relying on the Fifth Circuit's opinion in *American National Bank* (Pet. App. A6).

The salient facts in the two cases are identical for purposes of legal analysis. Critical to the conclusions of both courts of appeals were the following: that the banks bore no risks of fluctuations in the market prices of bonds; that their profits from the transactions were limited to the interest accrued while they held the bonds; that it was understood that the banks would permit dealers to "repurchase" bonds at the

original prices; that the banks never refused to "resell" the bonds to dealers; that, in almost every instance, the dealers in fact repurchased the bonds; and finally, that the dealers alone fixed the prices at which the bonds were sold to the public.[1]

In seeking further review, petitioner makes the same arguments that were made by the taxpayer in its petition for certiorari in *American National Bank*.[2] Those arguments are dealt with at length in our brief in opposition in that case, on which we here rely.[3] In addition, petitioner makes two contentions not advanced in *American National Bank*. Neither of these has merit.

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[1] As pointed out by the Sixth Circuit below (Pet. App. A6) and acknowledged by petitioner (Pet. 15), there are only two differences worthy of mention between the taxpayer's operations in *American National Bank* and those of petitioner. First, while in the Fifth Circuit case, there were no written agreements between the bank and dealers, petitioner's arrangements with dealers were in some instances reduced to writing. Second, the dealers in *American National Bank* had only the option to "repurchase" bonds, while the dealers here could be required by petitioner to "repurchase" bonds at any time in order to insure petitioner against a loss. If material at all, these differences would suggest that the instant case is stronger for the government than *American National Bank*. See Pet. App. A6.

[2] Like the taxpayer in *American National Bank*, petitioner asserts conflict regarding the proper scope of appellate review with *Commissioner* v. *Bank of California*, 80 F. 2d 389 (C.A. 9), and *First National Bank in Wichita* v. *Commissioner*, 57 F. 2d 7 (C.A. 10). Petitioner also cites *Commissioner* v. *Wells Fargo Bank & Union Trust Company*, 80 F. 2d 390 (C.A. 9). That case was decided in conjunction with, and on the authority of, *Bank of California*, without further opinion.

[3] Copies of our brief in opposition in *American National Bank* are being served on counsel for petitioner herein.

First, petitioner argues (Pet. 16-18) that the decision below conflicts with *Helvering* v. *Clifford*, 309 U.S. 331. The ultimate question there was whether the grantor of a short-term trust was taxable on trust income as owner of the trust corpus, even though in form and for local law purposes his wife was the beneficiary of the trust. This Court did not hold in *Clifford* that the question of ownership of property was one of fact, subject only to limited review on appeal, as petitioner contends. On the contrary, like the Fifth Circuit in *American National Bank* and the Sixth Circuit here, the Court recognized (309 U.S. at p. 336) that a number of considerations were relevant in determining the ownership of property and that no one fact was dispositive. In concluding that the grantor remained the owner and was taxable on the income of the trust, the Court stated (*id.*, pp. 336-337): "To hold otherwise would be to treat the wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance in such household arrangements." That, in essence, is the approach taken by the Fifth and Sixth Circuits in *American National Bank* and in this case. The approach of the circuit courts does not conflict in substance or in principle with this Court's brief references in *Clifford* (309 U.S. at pp. 336, 338) to the responsibilities of the trier of fact in cases of this type.[4]

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[4] *Helvering* v. *Clifford* was neither discussed nor cited in *Commissioner* v. *Duberstein*, 363 U.S. 278, upon which peti-

Second, petitioner urges (Pet. 18-19) that this is an important issue which should be settled by this Court in order to insure uniform treatment of banks engaging in similar transactions. But the clearly erroneous standard of appellate review for which petitioner contends would preclude (even within the same judicial circuit) the uniformity of treatment which petitioner says is essential. This is shown by the decisions on similar facts in *Commissioner* v. *Bank of California*, 80 F. 2d 389 (C.A. 9), and *First National Bank in Wichita* v. *Commissioner*, 57 F. 2d 7 (C.A. 10) (Pet. 13-15). In those cases, the Ninth and Tenth Circuits affirmed lower court holdings for the bank and the Commissioner, respectively, on the ground that there was record support for the opposite conclusions reached by the triers of fact.[5] Although the question presented here is not without significance in the area of financing dealers' inventories of municipal bonds, the decision below and

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tioner also relies (Pet. App. 16-18) in connection with its scope of review argument. As we show in our brief in opposition in *American National Bank* (p. 8), and as held by the court below (Pet. App. A5), the rule of the *Duberstein* case is inapplicable here.

[5] There is no merit to petitioner's claim (Pet. 19) that *Bank of California* is indicative of congressional policy regarding Section 103 of the Internal Revenue Code. That decision, being simply an affirmance on the facts of a lower court decision favorable to a bank, established no uniform federal policy with respect to the treatment of banks and dealers. Moreover, Congress' failure to react to *Bank of California* is no more significant than its failure to react to the decision favorable to the Commissioner in the *First National Bank in Wichita* case.

that of the Fifth Circuit in *American National Bank* do no more than bar the transfer to a bank of a tax exemption privilege which properly belongs to the dealers (but which they could not use to their advantage). There is thus no reason for further review unless and until a clear-cut present conflict arises in the circuits.

For the reasons stated above and in our brief in opposition in *American National Bank*, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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